

Counter-cyclical spending - where is it?

For some people the only purpose of a business is to make money for shareholders. For others there might be some underlying social investment - such as creating jobs or providing a better quality of life - but one thing is certain: without profit, no business is sustainable.

 By Paddy Hartdegen 11 Sep 2013

And when profits take a sustained dive, it's a worrying and unsustainable situation. So I was disappointed - not entirely surprised but certainly disappointed - to read that the profit margins for the construction industry as a whole had declined from 5% in 2009 to just 2,8% in 2011.

So for every R100 spent, just R2,80 goes back into the company and, considering that inflation, taxes and costs are rising all the time, the R2,80 is not going to allow the company to last very long.

For many years the construction industry has been based on cycles: boom then bust; boom then bust and these cycles seem to be endemic in an industry that relies so heavily on infrastructure, government spend and the profitability of others to provide the profitability they need.

Maintaining skills and expertise

Economists will keep emphasising that in times of economic recession - particularly when it comes to the building and construction sectors - the government needs to step in to provide the counter-cyclical spending that is needed to keep work flowing into the industry and maintain the valuable skills and expertise that has been built over hundreds of years as South Africa has grown.

So when the government announced its major infrastructure works programme - involving expenditure of R840-billion in many different projects - many companies in the building and construction sector breathed collective sigh of relief.

At least there would be some work flowing from the government even if the private sector investments were dwindling in the wake of overseas economic plundering by greedy profiteers taking advantage of the faith in the sustainability of housing in America and other markets too.

The scandals that followed, with banks collapsing, motor manufacturers needing government aid and widespread unemployment in America, Europe, and the Mediterranean (among others) made economic uncertainty levels even more pronounced. Shareholders, investors and the ordinary man in the street were scared - scared of losing his or her money, job, security and assets.

Look at countries such as Spain and Portugal today and you will see blocks and blocks of almost-completed homes standing empty and abandoned because contractors have gone bust one after the other. For them there was simply no hope that government counter-cyclical spending would keep them alive. Social grants would have to - along with the billions from European countries that had sustained this economic fiasco.

The picture was so bad, in fact, that entire countries (Iceland, Ireland, Greece to name a few) were basically bankrupt.

'Cash is king'

At the time it seemed that South Africa was well-shielded from these economic risks and South African banks, certainly, were better protected than those of America and Europe. At least, it seemed, South African money was safe.

When the government announced its infrastructure spending plan there was some relief but at the same time, private sector investors were sitting tight and, instead of investing money from profitable ventures, cautious shareholders chose to leave their money in their banks rather than use it.

So upwards of R800-billion (almost equivalent to the government's entire counter-cyclical spending programme) was earning interest in banks instead of being used to develop African markets. Companies with billions were listening to Warren Buffet and abiding by his rule that 'cash is king'.

Today, years later, the beleaguered construction industry is now teetering on the verge of disaster because no significant spending - from government or from the private sector - has been undertaken and the available amounts of work have dried up, putting an entire industry at risk.

Hardly the recipe for sustainable, long-term and wise development in a country that urgently needs such development. Let's put some figures behind these views:

- The construction industry's profit margins of 2,8% in 2012 were, according to Statistics South Africa, the lowest in nine other industries contributing to the country's gross domestic product;
- Despite being the lowest contributor to GDP, the construction industry employed almost a million people (supporting at least five million others in the process) in the formal and informal sectors.
- The mining and quarrying sector has profit margins of 16,5% while finance, property and business services reflects average profits of 12,1%.
- Profit margins for community and personal services are 9,2% and for the providers of electricity, gas and water supply services the profits were around 8,5%.

According to the Statistics South Africa report, expenditure in the construction industry was R256-billion in 2011 against income of R267-billion, which included interest, insurance and losses on financial and other assets.

Pierre Fourie, the operations director at Master Builders South Africa said, when the report was released, that it was "no surprise" that the profit margins were so poor as levels of activity had fallen so dramatically. He has called for - and even held - various construction 'indabas' to try and stimulate spending from both the private and public sectors.

And while companies and government departments agree that spending is needed, neither seem to put their hands in their pockets and take out the cash to pay suppliers in the construction and building sectors for the services and infrastructure that they can build so well.

What happens now? Are we all staring down into the abyss of business failures or will someone have the guts to actually mobilise the money and start spending? Or will construction companies simply look for work in other parts of the world?

That's probably exactly what they'll do (and are doing) with the consequent and severe impact such a move

will have on the whole country's future development.

And I keep wondering why it is that the people within those companies (banks, financial services, insurance and so on) who have made huge profits in South Africa can't (or won't) see that without the investment in development and infrastructure, the construction industry and its skills will be deprived of the right to earn a living. And they will quietly fade away to other spending markets of Dubai, East or West Africa, even Australia.

Fade away from a developing country that needs skills and investments more than anything else.

ABOUT PADDY HARTDEGEN

Paddy Hartdegen has been working as a journalist and writer for the past 40 years since his first article was published in the *Sunday Tribune* when he was just 16-years-old. He has written 13 books, edited a plethora of business-to-business publications and written for most of the major newspapers in South Africa.
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